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TAGS: [EPET](#) [EINV](#) [PGOV](#) [PREL](#) [KZ](#)
SUBJECT: KAZAKHSTAN - SPECIAL ENVOY GRAY DISCUSSES ENERGY
ISSUES WITH GOVERNMENT AND MAJOR COMPANIES

Classified By: Pol-Econ Chief Steven Fagin, Reasons 1.4 (b) and (d)

SUMMARY

¶1. (C) During July 22 meetings, Kazakhstani government officials expressed optimism to visiting Special Envoy Boyden Gray regarding the restructuring of Kashagan. They explained that Kazakhstan was moving forward with Azerbaijan and the companies on the Kazakhstan-Caspian Transportation System (KCTS). They indicated that there had been forward movement on expansion of the Caspian Pipeline Consortium (CPC) pipeline. The officials reminded Gray that Kazakhstan has only limited quantities of gas available. Western oil and gas companies stressed the high costs of energy exploration and development in Kazakhstan. End Summary.

OPTIMISM ON KASHAGAN

¶2. (C) Special Envoy for Eurasian Energy Issues Boyden Gray met in Astana on July 22 with Prime Minister Karimov Masimov, Deputy Energy Minister Lyazzat Kiinov, KazEnergy Chairman Timur Kulibayev, Samruk Deputy Chairman Kairgeldy Kabyldin, KazMunaiGaz (KMG) First Vice President Maksat Idenov, KMG Vice President Daniyar Berlibayev, and representatives of U.S. and other western oil and gas companies. Gray was accompanied by Eurasian Energy Diplomacy Coordinator Ambassador Steve Mann, SCA Deputy Assistant Secretary George Krol, and Ambassador Ordway. Gray explained to his interlocutors that he was particularly interested in discussing the latest developments in Kazakhstan's oil and gas sector, including the status of Kashagan, relations between the Kazakhstani government and the international energy companies, and energy transport issues.

¶3. (C) Gray's Kazakhstani government interlocutors stressed that Kazakhstan by and large enjoys good relations with the international oil and gas companies. The officials expressed optimism regarding Kashagan. Prime Minister Masimov explained that he had several days previously spoken by conference call to all the Kashagan partners. The key issues have been resolved, with the project ready to move forward. He noted that under the latest terms, the companies will bear all the costs for any additional delays of first oil beyond ¶2013. Providing additional details, KMG Executive Vice President Idenov said that Eni, which last year had fought furiously to remain sole Kashagan operator, would lose that status within a matter of weeks. Idenov's vision is for ExxonMobil to operate onshore activities and Shell offshore, with Total managing the Kashagan joint operating company and ConocoPhillips taking the lead on budget issues. Inpex, he noted, does not want to play a lead role. Idenov explained he had recently raised the needed \$3 billion for KMG to meet upcoming Kashagan cash calls, claiming that investors had actually oversubscribed, offering \$6.4 billion in total. Deputy Energy Minister Kiinov complained that Kashagan's

delays had forced Kazakhstan to make significant revisions to its development plans. The country had expected to be producing 130 million tons of crude by 2015. With the latest delay in Kashagan's first oil, that figure has been lowered to 100 million tons -- a big difference for Kazakhstan, he stressed.

KAZAKHSTAN-CASPIAN TRANSPORTATION SYSTEM

14. (C) KazEnergy Chairman Timur Kulibayev (who is also President Nazarbayev's son-in-law) reminded Gray that Kazakhstan and Azerbaijan had signed an Inter-Governmental Agreement (IGA) on the Kazakhstan-Caspian Transportation System (KCTS) in 2007. KCTS, he maintained, enjoys the support of Azerbaijan's President Aliyev, and KazMunaiGaz and Azerbaijan's SOCAR have agreed to exchange "task forces" to hash out further details, which will also require close consultations with the international companies.

15. (C) Kulibayev said the Kazakhstanis have been in discussions with Chevron on the pipeline portion of KCTS -- i.e., the pipeline to bring crude from the oil fields to Kazakhstan's Caspian coast. Chevron is prepared to move forward now, finance half of the pipeline's construction, and take an initial share of 50 percent while also agreeing to reduce that later to 10 or 15 percent to allow other companies to gain ownership shares. ExxonMobil, with its stakes in both Tengiz and Kashagan, is also positive on the pipeline, Kulibayev maintained, but not all the other companies in the Tengiz and Kashagan consortiums are on board

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yet. (Note: Idenov claimed that Total was a particular problem, as it would not be able to export to Iran if U.S. companies had equity stakes in KCTS oil terminals. End Note.) Kulibayev recognized that this is an issue for the companies to resolve, but said Kazakhstan would welcome USG assistance in getting them to resolve their differences. With a lack of agreement among the companies, Kazakhstan is constrained in negotiating with the Azeris on the trans-Caspian portion of KCTS and with the Azeris and Georgians on transport from Baku onward. In the meanwhile, TengizChevrOil is losing money by having to ship large volumes by rail, Kulibayev argued.

TRANSPORT FROM BAKU ONWARD

16. (C) Gray's interlocutors touched only briefly on the issue of moving crude from Baku onward. Masimov noted that Kazakhstan had committed to use the Baku-Tbilisi-Ceyhan (BTC) pipeline in 2006. Kazakhstan is pleased with how things have been developing. Masimov said the Kazakhstanis were discussing with the companies the possibility of building an additional pipeline from Baku, and did not think this would be a problem for the Azeris or Georgians. Kulibayev said the Georgians were vocally supportive of Kazakhstan moving its crude through Georgia -- and also welcomed KMG's acquisition of the Batumi oil terminal. The Georgians, he explained, were willing to give Kazakhstan all opportunities to use existing pipelines and build new ones.

CPC EXPANSION MOVING FORWARD?

17. (C) Masimov told Gray that Kazakhstan's success in moving forward on KCTS is leading to progress on expansion of the Caspian Pipeline Consortium (CPC) pipeline. KMG Vice President Berlibayev said that Russia's approach had changed on CPC and was now closer to that of the companies. The Kazakhstanis and Transneft had reached agreement. What is needed now is a political decision from the Russian

government, Kulibayev explained, adding that Kazakhstan hoped to get it soon. Kiinov argued that CPC expansion is particularly important in handling future Kashagan volumes, as Kazakhstan considers a trans-Caspian pipeline to be a no-go for now for political reasons, as well as because of the topography of the sea-bed. He also suggested expanding CPC to Odessa, to make the Odessa-Brody pipeline more commercially viable. This would require giving Russia a small share in CPC, perhaps 5 or 10 percent -- but that should not cause any problems, Kiinov argued.

LIMITED NATURAL GAS

18. (C) The Kazakhstani government interlocutors explained to Gray that Kazakhstan produces only limited quantities of gas, most of which is used for domestic consumption. Prime Minister Masimov argued that Kazakhstan had made a mistake in not focusing more on gas when it signed contracts for Tengiz and Kashagan that allowed the companies to reinject most gas. He said Kazakhstan would respect the sanctity of those contracts, but would separate oil and gas components in future contracts. Masimov noted that Kazakhstan actually has a shortage of gas in the south, because its gas is mostly found in the west, as a result of which it imports gas from Uzbekistan and is building a pipeline to bring gas from the west to the south. Masimov noted that Kazakhstan had started negotiations with ConocoPhillips and the UAE regarding "N Block," which may be a promising area for gas. Kulibayev noted the importance of a Kazakhstani gas pipeline to China, explaining that it will give Kazakhstan two gas customers. That said, gas is a very sensitive issue for the Russians, in a way that crude is not, he stressed. Kazakhstan has good relations with Gazprom, and both the Russian and Kazakhstani governments support Gazprom-KMG cooperation. Every year, Kazakhstan is getting a better price for the gas it sends to Russia, Kulibayev argued.

KMG RESTRUCTURING

19. (C) Idenov provided Gray with details on his efforts to restructure KMG. The company, he explained, owns many fields that are depleted, at the tail end of their production lives. KMG needs to focus more on mega projects that will provide large, long-term cash flows. KMG received \$1.4 billion in profit from Tengiz in 2007 (which yielded a total of \$7.2

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billion in profit for the whole consortium). Idenov alleged that former KMG President Uzakbai Karabalin had made a fortune through contracts KMG had with a company he owned. Karabalin had, in fact, tried to oust Idenov from the company, but in the end, President Nazarbayev supported Idenov, and Karabalin wound up losing his job.

TURKMENISTAN

10. (C) Mann requested to Masimov that the Kazakhstanis explain to Turkmen President Berdymukhamedov the importance of developing partnerships with the international energy companies, as Kazakhstan had done. Masimov promised to pass this request to President Nazarbayev. Kulibayev said there had been positive changes in Turkmenistan, and good relations between Berdymukhamdov and Nazarbayev, with the former willing to learn from the latter. He expressed doubts about Turkmenistan's capacity to meet all the commitments it had made on gas.

VIEWS OF THE WESTERN COMPANIES

¶11. (C) Kazakhstan-based representatives of international oil and gas companies told Gray that there is a very challenging backdrop to the exciting opportunities in Kazakhstan's energy sector. Campbell Keir, General Manager of Shell Kazakhstan Development, argued that the complexity of Kazakhstan's oil and gas projects, together with the fact that the country is essentially landlocked, results in very high operating costs, such that many projects are only worthwhile pursuing if crude is priced above \$85 per barrel. Project development is also hindered by a lack of infrastructure and of domestic human capital, he argued. Keir said that companies and governments should encourage the Kazakhstanis to package their energy development projects, as offering each project separately makes them too expensive. Keir pointed out the difficulties of offshore operations in the Caspian, where depths range from very shallow (1.5 meters) to very deep, with work particularly complicated below the salt layer. Steve Rose, General Manager of ExxonMobil Kazakhstan, said that there is still "lots of oil and gas" likely to be discovered in Kazakhstan; the question is the timeframe for mobilizing the resources to develop new fields, as well as whether it will be profitable to do so. Oil and gas transport is complicated too, with export routes largely having to cross multiple countries, Rose explained.

¶12. (C) Rose maintained that the Kazakhstani government was sending "mixed signals" on KMG. On the one hand, it wants the company to be an international leader. On the other hand, the crude export duty it recently introduced hits KMG very hard. The government is taking away KMG's cash flow at the same time KMG just increased its stake in Kashagan, which will not yield positive cash flows for many years. Responding to a question from Mann, Keir maintained that the Samruk state holding company, which is KMG's sole shareholder, plays an influential role in KMG when it wants to, noting it had reversed some of the personnel changes new KMG President Burkitbayev wanted to make.

¶13. (C) Mann asked the group how Turkey is regarded in Kazakhstan. Zamira Kanapyanova, Chevron Kazakhstan Country Manager, said that in general, relations with Turkey are good. There is appreciation for Turkey's early recognition of and support for Kazakhstan. That said, sometimes Turkey wants to play big brother, which does not go over well, Kanapyanova contended.

¶14. (C) Gray asked the company representatives on what issues the USG could be of assistance to them. Steve Rose responded that it is important that the companies be able to engage with the Kazakhstani government on its plans to introduce a new tax code. He also contended that the companies are being "eaten alive" by changing regulations, as a result of which Todd Levy, General Manager of TengizChevrOil, spends 75 percent of his time dealing with such issues, rather than with oil and gas. The central government, Rose argued, needs to find a way to better fund regional governments, so the regional governments do not have to raise revenues by finding ways to fine the companies for alleged regulatory violations. Rose also expressed the concern that with their growing income flows from increased production and higher prices, Kazakhstan and Azerbaijan would become complacent, satisfied with what they have, and not move forward expeditiously in resolving issues like transport.

¶15. (U) Ambassadors Gray and Mann have cleared this cable.

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